MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2016/2017

BBF3284 – INTERNATIONAL FINANCE

(All sections/Groups)

08 OCTOBER 2016
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 4 pages with 2 Sections only.

2. Section A: Answer **ALL** case questions.
   Section B: Answer any **THREE (3)** out of the FOUR (4) essay and calculation questions.

3. The distribution of the marks for each question is given at the end of each question.

4. Please write your answers in the Answer Booklet provided.

SECTION A: CASE QUESTIONS (40 MARKS)
INSTRUCTION: ANSWER ALL QUESTIONS

Currency drops over 40% in another sign of low oil prices hurting economies of major oil-producing nations

By
Carolyn Cui and Julie Wernau
Updated June 20, 2016 7:47 p.m. ET

Nigeria's currency plummeted more than 40% against the dollar on Monday, the latest sign that low crude-oil prices continue to disrupt the economies of some major oil-producing nations.

The steep losses in the Nigerian naira came on the first day of trading since the central bank **ended its currency peg to the U.S. currency.** Nigeria introduced **the fixed-currency regime a few years ago.**

Oil prices plunged about 75% between mid-2014 and early this year. While crude prices have bounced back in recent months, price levels remain roughly half of where they were about two years ago. That is pressuring many countries dependent on crude exports.

The naira had been pegged at 199 to the dollar but traded as low as 265 to the dollar Monday morning. The central bank suspended trading at midday because of an overwhelming number of dollar orders but little dollar supply, currency traders said. When activity resumed, the naira fell to about 280 to the dollar.

Based on the naira's exchange rate in black-market trading, it might continue falling until it loses as much as 70% of its value against the dollar, traders say.

Mr. Niepold said that for several months companies have been buying dollars on the black market, then raising prices to cover the added cost of inflated currency transactions.

For these companies, he said, a devaluation had "already essentially happened."

Foreign companies operating in Nigeria, such as airlines, have suffered, too. They have been unable to repatriate revenue earned in Nigeria. UBS analysts estimated the backlog to be about $4 billion.

Traders say Nigeria introduced the peg at least six years ago and has since moved the official value for naira a number of times. It is hard to know exactly when the fixed rate began as the government didn't highlight the moves. It began to set it at around 199 in early 2015.

Some analysts think the market might begin to attract fresh capital after the volatility subsides. Hedi Ben Mlouka, who manages the Duet EM Frontier Fund, said he has no exposure to Nigerian equities, but the devaluation will make some stocks more attractive. He thinks the fair value for the naira should be around 290 to the dollar.

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Nigeria's stock market has gained 8% in local-currency terms since the government announced last week its plan to end the currency peg. The stock market is up 2.1% this year, despite the country's economic troubles.

Michael Bolliger, head of emerging-market asset allocation at UBS Wealth Management, which oversees about $2 trillion in assets, said he has fielded several client inquiries about Nigeria.

"After losing so much value over such a short period of time," he said, "you have a very interesting opportunity potentially."

Adapted from http://www.wsj.com/articles/naira-plunges-after-nigeria-ends-dollar-peg-1466440618

QUESTION 1

Discuss the differences among the gold standard, fixed exchange rate regime and floating exchange rate system. (12 marks)

QUESTION 2

Briefly explain two (2) mechanisms by which a country (e.g. Nigeria) maintains a fixed-exchange regime. (10 marks)

QUESTION 3

In your opinion, why did Nigeria introduce the fixed exchange rate regime a few years ago? Why did they change it to a floating system recently? (10 marks)

QUESTION 4

Why Nigeria's currency plummeted more than 40% on the first day of trading since the central bank ended its currency peg to the U.S. currency? Discuss two (2) possible reasons. (8 marks)

(Total: 40 marks)

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SECTION B: ESSAY AND CALCULATION QUESTIONS (60 MARKS)
INSTRUCTION: ANSWER ANY THREE (3) QUESTIONS

QUESTION 1

Market tumult stemming from the United Kingdom's (U.K.) vote to quit the European Union (EU) drove the British pound to its weakest levels in three decades. Yet it also sent investors flocking to traditional safe haven assets.

i. Define safe haven assets. (5 marks)

ii. Discuss three (3) potential safe haven currencies. (15 marks)

(Total: 20 marks)

QUESTION 2

a. Profit estimates for Nissan Motor Co., Toyota Motor Corp. and Canon Inc. were cut by analysts after the United Kingdom's (the U.K.) decision to exit the European Union (EU). Describe two (2) possible causes as to why analysts cut their prediction. (10 marks)

b. ABC Associates, a U.S.-based investment company, borrows €100,000,000 at a time when the exchange rate is $1.3460/€. The entire principal is to be repaid in three (3) years, and interest is 6.250% per annum, paid annually in euros.

i. Calculate the dollar cost of this loan if the exchange rate remains? (5 marks)

ii. Calculate the dollar cost of this loan? The euro is expected to depreciate vis à vis the dollar at 3% per annum. Calculate the dollar cost of this loan? (5 marks)

(Total: 20 marks)

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QUESTION 3

a. On May 1, ABC, a wholly owned subsidiary of DEF (U.S.), sold a 20-megatwatt compression turbine to XYZ of the Netherlands for €4,000,000, due on 1 August. By the time the order was received on May 1, the euro had strengthened from $1.0800/€ to $1.1000/€. The 3-month forward exchange quote was $1.1060/€. ABC could borrow euros from the Frankfurt branch of its U.S. bank at 8.00% per annum. ABC could also borrow the US dollar from Citibank at 7.00% per annum. ABC estimates the cost of equity capital to be 12% per annum. As a small firm, ABC is unable to raises funds with long-term debt. ABC's director of finance now wondered if the firm should hedge against a reversal of the recent trend of the euro. Recommend two (2) hedging strategies with calculations. Based on your answer, which one is preferable? (10 marks)

b. Identify five (5) main causes of market segmentation. (10 marks)

(Total: 20 marks)

QUESTION 4

a. Suppose that an iPhone is selling for US$800 in the United States (U.S.) and for £500 in the United Kingdom (U.K.). Assume that the current exchange rate is £1.0000 = US$2.0000. Can arbitrage happen? Outline your strategy with calculation. Ignore exchange rate risk, transaction costs and changes in the prices of iPhones. (8 marks)

b. i. What is covered interest arbitrage? (2 marks)

ii. Suppose that the Eurodollar rate is 8% per annum, and that the Euroyen rate is 4% per annum. Suppose further that the spot rate is ¥106/$ and the 180 days forward rate is ¥103.5/$, calculate the profit using the covered interest arbitrage strategy. (10 marks)

(Total: 20 marks)

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